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SUBJECT: 2007 BUDGET UPDATE

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¶B. 06 ABUJA 2644

¶1. SUMMARY: On January 8, 2007, the Ministry of Finance (MOF) held a briefing discussing the 2007 budget. President Obasanjo submitted the budget to the National Assembly (NA) on October 11, 2006 and it was passed on December 20, 2006. The budget cycle for the GON is by calendar year and this is the first time since 1999 that the budget has been passed by the NA before the new year started. The 2007 budget has three main goals, delivering economic growth and wealth creation, reducing poverty and achieving the Millennium Development Goals (MDGs) and ensuring macroeconomic stability. END SUMMARY.

¶2. Presentations were made by the Minister of Finance Nenadi Ester Usman, Director General Budget/Special Advisor, Mr. Bode Agusto and the Chairman House Committee on Appropriation, Farouk Lawan. Regular updates on the implementation of the budget will be made as has been the practice since 2004. The 2007 budget had three main goals, delivering economic growth and wealth creation, reducing poverty and achieving the Millennium Development Goals (MDGs), and ensuring macroeconomic stability.

OVERALL BUDGET FIGURES

¶3. Summary of 2007 budget:

Revenues -- 1.729 trillion naira (decrease from 1.765 trillion)

Expenditures -- 2.308 trillion naira (increase from 2.260 trillion)

-Statutory -- .102 trillion naira
-Debt Service -- .326 trillion naira
-Ministries, Departments and Agencies (MDA) -- 1.880 trillion naira (up from 1.832 trillion)

Deficit -- .579 trillion naira (increase from .496 trillion naira)

GDP -- 17.338 trillion naira (no change)

Deficit/GDP -- 3.3% (increase from 2.9%)

¶4. Agusto outlined how spending was controlled at the federal level by the GON. The National Economic Empowerment and Development Strategy (NEEDS), and the Millennium Development Goals that addresses long term poverty reduction strategies were the starting points. From these were generated a "Fiscal Strategy Paper" with a medium term revenue and expenditure plan. The strategy paper had

specific sector strategies that also laid out a medium term strategic plan for all MDAs of the GON at the federal level. Annual budgets were then developed that set out the yearly spending for the MDAs. After passage they are to be implemented, with monitoring and reporting on a quarterly/half-yearly basis.

Budget Parameters

¶5. As reported in reftels the key assumptions and targets for 2007 remained the same except for Value Added Taxes (VAT). Previous assumptions were at 10%, but the rate was left at 5% as it had been for 2005 and 2006. This change will reflect a reduction in estimated non-oil related revenues. For ease of reference the budget parameters are repeated here compared to the 2006 budget with the new changes noted from reftels.

-- Crude oil benchmark price of $40 per barrel, up from $35 per barrel. No change from reftels.
-- Crude oil production of 2.5 million barrels per day (mbpd). No change from reftels.
-- Joint venture cash calls of $ 4.5 billion, up from $4.20 billion. No change from reftels.
-- GDP growth of 10%, up from 6.9%. No change from reftels.
-- Inflation rate at 9%, down from 10.9%. No change from reftels.
-- Exchange rate of 126 naira to $1, down from 129 naira. No change from reftels
-- Value added tax (VAT) rate of 5%, which is lower than the earlier reported figure of 10%, because the anticipated VAT increase was not passed.
-- Weighted average duty rate of 17%. No change from reftels
-- Weighted average interest rate of 9%, down from 13%. No change from reftels

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Revenue and Expenditures

¶6. Estimated revenue, expenditures, budget deficit and the deficit as a percentage of GDP changed as reported in reftels. Estimated gross consolidated revenues changed from 4.3 trillion to 4.027 trillion naira. The difference .265 trillion naira is a result of reduction in VAT from the initial 10% to 5%. Oil revenue projections remained the same at 3.2 trillion naira but non-oil revenue decreased from 1.1 trillion naira to .794 trillion naira, again as a result in reduction of income from VAT. As mentioned in reftels, it was hoped that the tax bill would have been passed before the end of 2006.

Ministries, Departments and Agencies Spending

¶7. The NA increased MDA spending at the federal level (as opposed to the state and local level) to 1.9 trillion naira approximately a 1 billion naira increase. Recurrent (non-debt) expenditures including payroll and overhead account for 56% of MDA spending, while capital expenditures account for 44%. A further breakdown by ministry/sector as a percentage of MDA:

- Ministry of Works -- 12%
- Security -- 12%
- Education -- 10%
- Health -- 7%
- Water -- 6%
- Power -- 6%
- Federal Capital Territory (Abuja) -- 4%
- Petroleum Support Fund -- 4%
- Pension -- 4%
- Public Sector Reform -- 2%
- All others --33%

Statutory Transfers

¶8. There was no change in statutory transfers from reftels and for ease of reference are repeated here. Total estimated statutory transfers in 2007 will be 102 billion naira ($803 million).
-- 43 billion naira ($338 million) to the National Judicial Council, a 23% increase.
-- 24 billion naira ($189 million) to the Niger Delta Development Commission, an 8% decrease.
-- 35 billion ($275 million) to the Universal Basic Education Commission, representing a 13% increase.

Debt Service

¶9. At the end of June 2006 the total debt stock was 2.4 trillion naira ($18.9 billion), comprising domestic debt of 1.8 trillion naira ($14.2 billion), and external debt of 616 billion naira ($4.8 billion). Also, the 20% increase in domestic debt from 1.5 trillion naira ($11.8 billion) to 1.8 trillion naira ($14.2 billion) was due to the planned payment of contractor and pension arrears amounting to 150 billion naira ($1.18 billion), and 75 billion naira ($590 million) respectively.

¶10. The cost of servicing domestic debt remained unchanged at 265 billion naira ($2.1 billion), this includes borrowing of 200 billion naira to fund the 2007 budget deficit, pensioner bonds at 75 billion naira, contractor bonds at 150 billion naira, and an amount set aside for the Central Bank of Nigeria for liquidity management. Foreign debt service will remain at 61 billion naira ($480 million) from a high of 181 billion in 2005. The reduction is a result of payment of their Paris Club debt in 2005/6 and planned exit from London Club debt this year.

Petroleum Products Subsidy

¶11. There was no change to President Obasanjo's announced reduction to the petroleum subsidy from 75 billion naira ($590 million) to 50 billion naira (394 million). The total budget amount is 100 billion ($787 million), and the additional 50 billion naira ($394 million) was carried forward as a result of a shortfall in the 2006 budget. Although 75 billion naira ($590 million) was provided in the 2006

budget, 120 billion naira ($945 million) had already been spent by mid-2006, while the subsidy is expected to increase to 250 billion naira by the end of 2006. The GON's share of the expenditure would be 125 billion naira ($984 million). This 50 billion naira ($394 million) shortfall has been provided for in the 2007 budget. (Comment: In early December 2006 the IMF released the second review of the Policy Support Instrument for Nigeria. The paper said that despite political pressures as a result of the upcoming elections the GON had decided to increase fuel prices early this year and that the medium term strategy should be to decrease the fuel subsidy even further. It appears however, that the GON has backed off plans to increase prices before the election, but rapidly dropping crude prices will reduce the subsidy burden. End Comment).

2007 General Elections

¶12. For the upcoming general elections, the NA increased the budget for the Independent National Electoral Commission (INEC) from the 27 billion naira as reported in reftels to 29.1 billion naira in the 2007 budget.

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Excess Crude Account (ECA) - Financing Development Projects
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¶13. (U) Not much was discussed on the additional spending on

infrastructure from the excess crude account that had previously been mentioned in reftels. The proposed projects in railways, power generation and gas were valued in US dollars, but this briefing valued them in naira.
-- Railways: 81 billion naira (GON share at the federal level is 37 billion) is to be spent over the next four years to lay new standard gauge double tracks with a speed of 150 kilometer per hour from Lagos to Kano via Abuja, Minna, and Kaduna.
-- Power: 280 billion naira (GON share at the federal level is 128 billion naira) for the Niger-Delta Integrated Power Plants to increase current capacity by 68%, conversion of existing plants increasing capacity by 28% and the Mambilla Power Project that will generate 2,600 MW; increased the transmission network by 48% and a 22% increase in the total distribution network.
-- Gas: 794 billion naira (GON share at the federal level is 364 billion naira). 147 billion naira for the OK Pipeline project (GON share at the federal level is 67 billion), 531 billion for the Brass LNG Plant (GON share at the federal level is 244 billion), and additional gas supply of 116 billion naira (GON sQre at the federal level is 53 billion naira.

Comment

¶14. Although the budget was passed by the NA and signed by the President; there are many questions remaining such as will monetary policy keep pace with fiscal policy? Can inflation be controlled and reach single digits? When will the fiscal responsibility bill pass? At the same time, there exist long lines for fuel in all major cities due to anticipation of rumored price hikes. Black market operators are taking advantage. The swift approval of the budget by all parties is a positive sign that the GON is taking seriously its budget obligations. How the budget is implemented will be the true indicator of greater GON fiscal responsibility. The level of oil production, however, is one possible problem with the budget, as Nigeria is currently producing about 2 million barrels per day, 20% less than the level of production assumed in the budget, which is currently more than Nigeria's pledged OPIC target. In the past some of the difference has been made by topping off from the ECA, but as oil prices drop closer to the reference price, production cuts could began to affect budget assumptions materially.

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